RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 7, 1994 **LETTER 1162**

THE PICTURE: Question: Russell, what do you make of this market so far?

Answer: My opinion? No different from what I've been saying ever since my "Special Bear Market Letter" of April 1. I started that Letter by saying, *"Yes, this is a primary bear market."* And I closed that Letter with the sentence, *"This is a bear market."* So, I've never wavered -- I've insisted ever since April 1 that we are in a primary bear market. And I've stressed that in a primary bear market our position is *"on the sidelines," "out of the market."*

Question: Right, but what else do you see?

Answer: Well, the most ominous thing about the situation so far is that I don't see many people calling this a primary bear market (assuming, of course, that they even know what a bear market looks like). On the contrary, what I do note is the majority of analysts and commentators simply **focusing on what the Fed has done**. "Darn, they've raised rates again," and, "Oh, they've gone too far in their tightening, and that's why the market has been going down."

Baloney, this bear market began last February **well before** anyone was complaining about the Fed and higher rates. But the incredible (and ominous) fact is that even now you hardly hear anyone talking about a "primary bear market." No, everyone is simply mouthing that this is a market that's being frightened by higher rates.

I'll go further. I have a "secret" theory. It's this -- I believe all the blame about rate boosts knocking the stock market down is **serving as a cover-up.** What does all this interest-rate blame cover up? I believe it covers up the true situation, which is that **this bear market is based on a lot more than just rate boosts.** This bear market is based on extreme overvaluation, the old age of the preceding bull market, far too much public participation, far too much debt, an absolutely absurd number of mutual funds, and, of course, too much speculation.

Furthermore, over the last 20 years stocks have appreciated at an average rate of 15%, which is, historically much too high. So we have to be prepared for that old law, "regression to the mean." This means that when the price action varies too far from the long-term average, it will make up for its "transgression" by moving the other way, back to the mean. The average increase for US stocks (including dividends) over the last century was about 10%. But we've had 20 years of around 15% appreciation, which is far above the mean. This suggests that somewhere ahead we will be facing a number of years of **below 10%** appreciation, and I'm talking about not only sub-standard years but **negative** years. Of course, when you talking about "negative years" you're talking about a bear market.

Question: What do you see as the important technical question facing the stock market?

Answer: Without question, I see the most important question as this -- will the big averages hold above or break below their **April lows**? The April lows were **3593.35** for the D-J Industrials and **1546.02** for the Transports.

The Transports have already violated their April low. The Transports broke their April low back in September, and they are

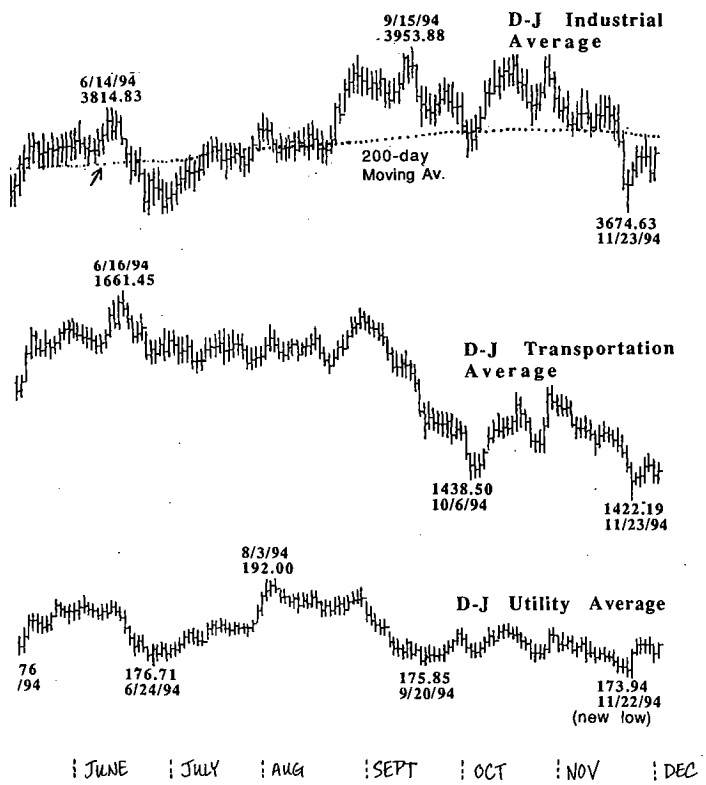
Nov. 25 DJIA 3708.27; PTI 3936; A-D Ratio -10.10
Dec. 2 DJIA 3745.62; PTI 3936; A-D Ratio -10.07
Dow Yield: 2.84%; Dow Price/Earnings: 17.6
Dow 200-day MA: 3781; Dow 30-day MA: 3808
Dow Times Book Value: 3.35; PTI 89-day MA: 3986
Percentage of Undervalued Blue-chips: 12%
Dow Low Risk Buy Index: 0; Gold-PTI: 737
Gold 200-day MA: 384.71

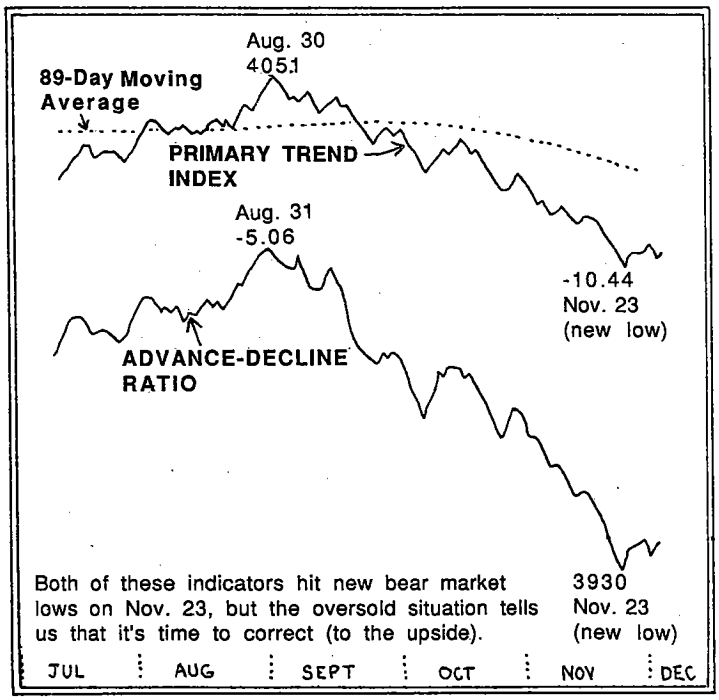
now far below their April low. The Industrials have still not violated their April low. I believe Industrials will break their April low -- in due time. If that happens, we will have a re-confirmation of the primary bear market (under Dow Theory). Furthermore, if the April lows are violated, I would expect the second phase of the bear market to begin.

I believe that a breaking of the Dow April low will finally set off the cry (by all the late "experts") of "it's a bear market." Furthermore, I believe a breaking of the April low will set off a major and extended market decline, one which will prove far more damaging that what we have seen so far. I'll go into that thoroughly if and when it occurs.

It is well to know that the April low for the S&P 500 was **438.92,** and the April low for the NYSE Composite was **243.14.** Watch those numbers. I don't know which one of the three -- the Dow, the NYSE or the S&P -- will violate their April low first. But I would bet that if one goes, they will all go.

Consider this: Douglas Kass (JW Charles Securities, Inc.) estimates that 75% of all money in equity mutual funds **since**





1960 has been invested over the **last three years.** The dollar weighted price of those investments is 3485 on the Dow and 436 on the S&P. **Russell comment:** In other words, if those numbers are violated, the great majority of equity mutual fund buyers will find themselves "under water." And if that happens, I would expect a slow (but accelerating) march by fund-holders to the exits.

Question: Isn't the takeover of Congress by the Republicans a bullish factor for the stock and bond markets? After all, the Republicans are the party that business favors.

Answer: The rise to power of the Republicans could be a long-term, fundamental plus for the nation -- assuming the GOP can avoid gridlock and get something done, and assuming Clinton doesn't fight Republican plans via the veto. In the big picture, any turn away from the welfare state would be a major plus for the market and for the nation.

But let's face it -- can the Republicans erase the fact that this market has been chronically **overvalued** for almost three years? Can a Republican Congress blot out the fact that the S&P is selling at a dangerous 35 times dividends? Can the ascent of the Republicans eliminate the fact that our national debt is approaching $5 trillion, and that we are still running hugely negative trade and current account balances? Can the Republican Congress erase federal deficits of 790 million dollars a day?

No, this primary bear market is not based on Fed tightening. The bear market began nine months ago back in February. If the Republicans do everything right over the next few years and if Clinton goes along with their actions, then that might conceivably mitigate the severity of the bear market. But the operative principle is that once started, bull markets and bear markets **run to conclusion.** Politicians and their laws and actions **may re-arrange how** bull and bear markets arrive at their ultimate targets. But politicians cannot change the fact that bull and bear markets do not and will not end until their upside or downside targets are reached.

Question: Russell, what do you foresee as the final downside target for this bear market?

Answer: First, I should repeat the Dow Theory adage which states, *"Neither the duration nor the extent of a primary movement can be predicted in advance."*

Next, let me include some observations. Historically, bull markets have no relationship with the bear market that precedes them. However, bear markets do have a relationship with the bull market that precedes them. Remember, the function of a bear market is to correct the excess of the preceding bull market.

We know this -- all primary bear markets in history have wiped out at least half of the gains of the preceding bull markets. Furthermore, the bigger and more speculative the bull market, usually the bigger and more costly that bear market correction that follows.

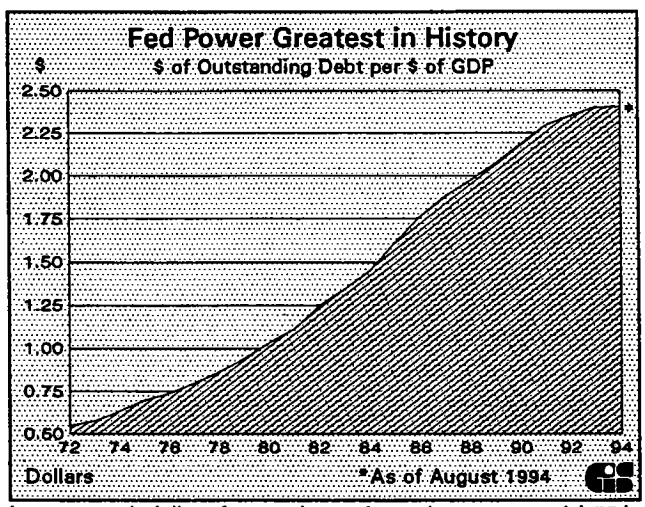
Which brings up the unpleasant thought that the 1974-94 bull market was the longest (in duration), one of the largest (in percentages), and certainly the most speculative bull market in history.

On this basis, I would expect one hellish bear market to lie ahead. Most primary bear markets end with the Dow yielding in the vicinity of **6%** or more. If this bear market was to take the Dow down to where it ultimately provided a yield of 6%, then based on the current Dow dividend of $107.85 (and assuming no dividend cuts) we could expect a final bear market low for the Dow in the neighborhood of around 1798 (or lower).

The 1974-94 bull market began at a Dow low of 577. It climbed 3401 points before it expired. If the Dow was to give back only half of its 1974-94 gains, it would decline to 2277. Based on past history (i.e., the fact that all major bear markets erase at least half of the previous bull market's gains), I would expect the Dow to break below 2277. And as I said, if the Dow was to decline to the point where it yielded 6%, it would drop a further 477 points to around 1800.

Question: What do you make of all the screaming and gnashing of teeth over the Fed's raising interest rates?

Answer: Well, most of Wall Street knows about the "Three-Steps-and--Stumble" rule regarding rates and stocks. But there's another factor, and it can be seen in this critical chart and comment from *Bill Gary's Price Perceptions* -- (800) 231-0477. Read this carefully.



In 1972, each dollar of gross domestic product supported $.55 in debt. Today, each dollar of gross domestic product must support $2.40 in debt. In 1972, a one percent change in interest rates would increase interest payments by $17 billion, or .5 percent of GDP. Today, a one percent change in interest rates would expand interest payments by $123 billion, or 2.4 percent of GDP. In other words, a one percent change in interest rates will impact the economy four times greater than in 1972. *The Fed's leverage over economy has increased 400% since 1972.*

Question: How much credence do you give to the Kondratieff Wave thesis or the Elliott Wave theory?

Answer: Where the market is concerned, I don't rule out anything. Many years ago I did a good deal of work and wrote quite a bit on Elliott, but now I leave that to my old friend, Bob

Prechter (PO Box 1618, Gainesville, GA 30503). By the way, Bob thinks that 1995 will be a fateful year for the market. He bases this on the Fibonacci series (1,2,3,5,8,13, 21, 55, 89 etc.). Bob notes that 1995 is 21 years from the seminal 1974 low, it is 13 years from the upside breakout of 1982, it is eight years from the massive crash of 1987, and it is five years from the crash of 1990. All just coincidences?

Here's a quote from one of Prechter's August reports: *"I believe that the disinflationary period that has now lasted 13 years is about to resolve into severe deflation. The reason that inflation is not an option is that the national 'money machine' is not printing cash, but issuing debt. When the defaults are figured, the value of debt can contract faster than authorities can print currency."*

Russell comment: I agree with most of the above. However, the Fed cannot "print" cash. We run on a debt-credit system, and the US money supply is increased when the banks make loans. If **bank lending** contracts, the money supply also contracts. Therefore, if the bear market results in a cut-back in bank lending (which I think it will) -- watch out.

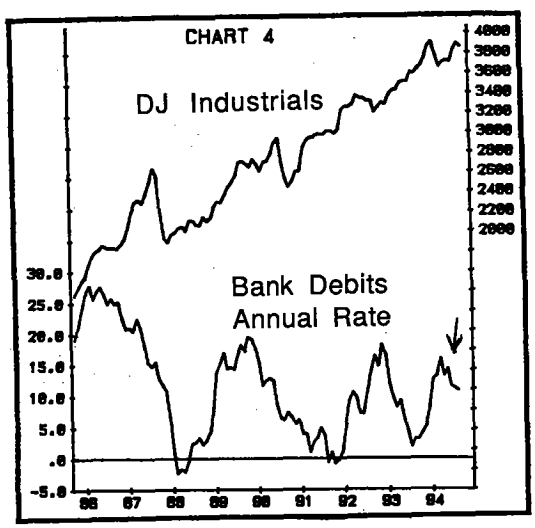
As for Kondratieff, this so-called "long wave" theory tells us that every 50-60 years there comes an extended and crushing deflationary period. Many Kondratieff aficionados believe we are moving into that period now. Possible? I think it is. As you know, I think deflation is in our future.

Question: Russell, what about your Primary Trend Index (PTI)? Is it telling us anything?

Answer: I keep a long term point & figure chart of the PTI going back to 1971. Since 1974 the PTI has been rising in one huge, seemingly unending spike. The PTI started the bull market at a **low of 125** on December 27, 1974. It hit its bull market **high** at **4098** on February 2, 1994. Since 1974 we've never experienced a FULL correction or a major bear market in the PTI. If the PTI is to fully correct the **3973 points that it has gained** during the 1974-94 bull market, then we've got one long, long trip down. So far, the PTI is down just 155 points. This amounts to a mere **3.9%** correction of its 1974-94 gains. Not very much.

Question: You keep talking about the "reverse wealth effect" in a bear market. Please amplify.

Answer: It's simple enough. As the bear market wears on, people start totaling up their losses. When they see what has happened to their investments, they also "feel" what has happened. That's when they get frightened. And along comes the reverse wealth effect. The husband cancels his order for the new Chrysler, and his wife puts off buying the new sofa. And there are fewer goodies for Junior. The reverse wealth effect is in progress, and it's a major negative for the economy.



Question: If deflation and the reverse wealth effect lies in our future, won't it start with business turning down?

Answer: Probably. One place to watch as far as business activity is concerned is the trend of bank debits. Bank debits deal with **bank checking activity** and note on this chart that bank debits have recently turned down. This could be the start of something big (chart courtesy of *Juncture Recognition*, Box 1209, Pompano Beach, FL 33061).

As a matter of interest, I note that "investment genius" George Soros (or his funds) have lost around one billion dollars this year in wrong bets on the yen (he thought the yen was headed lower). Just as interesting is the news that a Soros fund which had taken a large position in British real estate, has now bailed out. (Is Soros seeing deflation in real estate's future?)

Soros sells UK portfolio and pulls out of property market

By Simon London in London

Mr George Soros, the international financier, is pulling out of UK commercial property only 18 months after announcing plans to make a "long-term" investment of up to [illegible]

rency and bond markets. Shares in his flagship Quantum fund have fallen from $25,282 to $19,670 during 1994.

The 200 shareholders in Quantum UK Realty, mostly wealthy individuals and institutions [illegible]

bought a 5 per cent stake in British Land which it said was a long-term holding. These shares were sold in July at a 35 per cent profit.

Mr John Ritblat, British Land chairman, said: "We have got the other half of a portfolio which we

Question: Your chart of the advance-decline ratio on page 2 is rather scary, but isn't it distorted by the decline of all those interest-sensitive stocks?

Answer: Sure, it's affected by the decline of the interest-sensitive stocks. But "distorted"? Listen, those stocks **represent values** too. There are about 1,000 preferreds and closed-end bond funds listed on the NYSE. They acted as a positive during the bull market, but now they're a negative in the bear market. Nevertheless, each day when the sun goes down every one of the interest-sensitive stocks is owned by someone. And as those hundreds of stocks head south, their owners are that much poorer.

Then there's the **NYSE Financial Index**, which I've discussed many times, and which has been hitting new lows. This comprehensive index includes over 1,000 NYSE stocks, all money related, such as banks, closed-end bond funds, small loan companies, brokerage houses, insurance companies, S&Ls. The current series of new lows in the NYSE Financial Index is also a bearish factor.

Question: What effect do you think the slump in the bond market will have?

Answer: The bond market is very much larger than the stock market, but here again we have the negative wealth effect. The estimate (provided by *Fortune* magazine) is that over $600 billion have been lost in the US bond market, while worldwide over $1.5 trillion have been lost in bonds (and this estimate is not up-to-date).

Question: What about Wall Street and the financial industry itself?

Answer: Another source of the reverse wealth effect comes from the endless series of lay-offs and firings that has impacted on industry. Along these lines, you might ponder the following:

I've said many times that when the trouble comes, it **first shows up on Wall Street**. So far, this bear market has been no exception. The following is from the November 15 *New York Times:* "Amid its worst slump in recent memory, Goldman Sachs & Co. has begun laying off investment bankers. At least a few bankers have already been given their walking papers, executives said, and others will be notified soon. 'Due to the prolonged, industry-wide turndown, some belt-tightening has been necessary,' Goldman said in a statement yesterday. . . Like other Wall Street firms, Goldman Sachs incurred large trading losses earlier this year when interest rates began to rise, sending bond prices plunging." **Russell comment:** Last week we heard that Goldman will be giving out its smallest bonuses in years, just 8% of salaries for '94. Many Wall Street workers depend on bonuses for a large part of their income.

Well you get the idea. I use the Goldman situation because Goldman is the most profitable firm on Wall Street. If they're firing people and slicing bonuses, you can imagine what's happening in the less-successful firms.

Question: Russell, you've been warning about deflation. Assuming you're correct, what can we do to protect ourselves?

Answer: The ideal stance in the face of deflation is (1) ample liquidity, (2) plenty of savings, (3) little or no debt. This is hardly the posture which American consumers and American corporations find themselves in. Of course, there's a limit to how far you can or should go. I'm not advocating dumping your house on the market, but at the same time I'm not advocating buying a house or 10 acres in Connecticut or say buying a collector's edition Rolls Royce. During a deflation, prices go down. That's the operative thought that I'm trying to get across. So far, stocks, bonds, commercial real estate and most housing has been deflating. I expect this trend to spread out to all areas.

Along these lines, I believe that the gold market is telling us something here. That something is simply, *"Don't believe what you hear, inflation is not the problem in our future."* The gold shares move up when the metal moves up, but when the metal is static or sliding, the gold shares often take a beating (since people don't buy or own gold stocks for income purposes). Lately, we've seen gold back off reluctantly while the stocks have declined substantially. Gold coin and bullion owners are holding on to their gold. In a deflation, gold (with no debt against it) continues to be the ultimate store of value. But the gold stocks are another story -- without inflation in our future, the gold stocks become much less attractive. And they don't have fat dividends to hold them up.

Question: Doesn't it bother you that nobody else (except Bob Prechter) is talking about a major bear market? I mean, what's to cause it? Business may slough off some, but nobody's talking about a severe recession or a depression. C'mon, Russell, why so glum?

Answer: It's not that I'm glum. I am simply talking about probabilities now that the primary trend has turned down. If there's one thing I've learned in this business is that the major moves, the BIG moves in the market, only occur when they are considered well nigh impossible.

I remember during the '40s and '50s that nobody believed the Dow would ever advance over its 1929 high, at least in our lifetime. Yet in November 1954 the Dow did finally (after 25 years) climb above its 1929 high of 381. After that, nobody thought the Dow would ever advance above 1000. That figure seems absurd, yet on November 14, 1972 the Dow closed at 1003.16. A year later, in January 1973, the Dow hit an all-time high of 1053.70. Yet, who would have believed that late in the next year the market would smash to a low of Dow 577.60?

All those moves were considered "out of the question" prior to their occurring. So if I'm correct, if I'm right about this being a primary bear market, then why is it so ridiculous to think that stocks could go down to undervaluation again, and why is it so ridiculous to think that the Dow could yield 6% again?

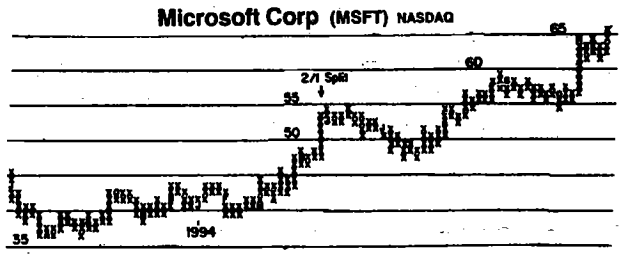
The fact is that if it was generally conceded that this was a bear market and if it was generally conceded that the Dow would decline to a 6% yield, then I would be suspicious that it would happen.

But I know from experience that major moves can only occur when they have not been discounted. Or to put it another way, major moves can only occur when the vast majority of investors believe that they cannot and will not occur.

Question: Russell, in the "old days" US Steel and then GM and later IBM were considered THE bellwethers of the market. Is there a stock that you are watching now?

Answer: Yeah, I guess so. I'm watching today's mighty glamour stock, **Microsoft.** Microsoft is the leading light, the hot stock, situated in the hottest industry -- software. MSFT has no debt, it's doing everything right, its young CEO is a national icon plus being the richest man in America. The company is selling at an astronomical price of five dollars for every dollar of sales (the big oil companies sell at around 50 cents on a dollar of sales) and every analyst adores it. If Microsoft takes the gas, you'll know that this is indeed a bear market.

This point & figure chart of MSFT shows the stock moving up from 37 in 1993 to a recent high at 66. Let it drop below 60 and MSFT is in trouble. So I'm thinking that MSFT is the stock to watch. [Chart by my old friends at *Market Charts,* Inc., 10 Hanover Sq., NYC 10005, (212) 509-0944.]



INVESTMENT POSITION: Sorry, it may be boring, but bear with me -- the bear remains in the box. No sense writing a big treatise here, simply realize that this is a bear market. **In a bear market time works against the stockholder** (since values deteriorate through time when the bear is in the box).

A bear market means that it's a good time to take a vacation. Stay away from the market, and you'll stay ahead of the game. I have to smile as I read most of the advisories received here each week (along with magazines and newspapers). What do the advisors talk about? You guessed it -- they talk about what stock to buy. Buy, buy, buy, that's their main preoccupation. And let's face it -- it's their living.

Happily, my sophisticated subscribers don't force me to indulge in such nonsense. In a bear market you ignore buy advice. But market mavens, advisories and brokerage houses don't make a living advocating a "sit on cash" stance. But ponder this -- have you ever seen a brokerage office manager walk up to one of his brokers and ask, "Charlie, you haven't talked about it lately, but how are your customers doing?"

NOTES & QUOTES: Barry Goldwater (Mr. Republican) is 85, but he still has a few cogent things to say (Barry was never shy with his opinions). Says Barry: (1) Former President Bush couldn't hold a candle to his father, GOP Sen. Prescott Bush. (2) Barry likes Reagan. "It was me who got Reagan into politics. If it hadn't been for me, he would never have stopped chasing cows." (3) Jimmy Carter is a "nice, little carpenter boy from Georgia. That's about all." Recently, Barry stunned some Republicans by coming out for pro-choice and for lifting the ban on gays in the military. Says Barry, "You don't live 85 years and not change a little bit." Barry re-married two years ago, to Susan who is aged 53. Keep goin', Barry.

* *

TAX 'EM: According to the Tax Foundation, a median two-income family will pay **40.1% of its income** this year in total federal, state and local taxes. That includes income taxes on property, sales, social insurance and other taxes. **Russell comment:** 40.1% is a damn disgrace. 40.1% of your income for what? No wonder there are no savings in this country. No wonder many wealthy people who can afford it are moving out of the US.

The figure I hear is that roughly 250,000 a year are waving "Good Bye" to the Statue of Liberty. The main reason -- their liberty is being taxed away. Plus escape from crime. Unfortunately, many of these represent the smartest and most productive people in the country. It's a shame.

* *

Well, I bought and installed one of those new 18" satellites, and I can tell you that the move is a winner. I haven't counted them, but I get over 100 channels including around 15 24-hour music channels (everything from jazz to classical to rock and variations thereof). There are dozens of movies going on simultaneously around the clock, plus more dozens of late-release pay-per-view films. Price was $900 for installation plus $30 a month for the service. Next to cable (which I still have) the satellite is a bargain (watch cable prices come down). And let's face it, the world is becoming a lot smaller. All the amazing new communications capabilities will mean that many people can live anywhere and still be tuned in to what's happening (this will mean a "new world" for retired people who want to escape the danger, the expense and the hassle of big cities).

I find it hard to remember what it was like before TV and before radio was widely used. Oh yeah, I remember, we used to read a lot. People don't do that very much today.

* *

I continue to rail against the lies our politicians put forth regarding the deficits and the national debt. The fact is that the government continues to borrow against the Social Security trust and other trust fund surpluses (it amounts to $70 billion a year). They then use the borrowed money to "lower" the deficit figure, although it's a blatant lie (the fact is that this borrowed money is counted as both revenue and a liability simultaneously). It all shows up in the additions to the national debt figures. Here are those figures up to date: Current national debt = $4.754 trillion. Exactly 12 months ago it was $4.469 trillion. Addition to the national debt over the past year was $285 billion. Anything else is a lie.

* *

Is Clinton heading for real trouble? The Whitewater "hearings" so far have been a joke, and anything damaging to the Clintons was ruled "out of bounds." But now those two pit bulls, Jim Leach and Alphonse D'Amato (Senate and House Committees) vow to get at the truth (remember, the Republicans now run the committees that have the investigative power). Writes Davidson of *Strategic Investment* (824 E. Baltimore St., Baltimore, MD 21202), "Faced with the likelihood that information linking Clinton with drug use, drug dealers, money laundering and murder will be developed in Congressional testimony. The press will suddenly 'discover' what has been there all along . . . FBI agents and police officers will be more aggressive in investigating. Prosecutors will feel more confident in pressing charges. Editors who killed stories will reassign them to their best reporters . . . Prediction: Clinton will be gone by summer." **Fact:** Special counsel Kenneth Starr is expected to seek indictments soon (Arkansas grand jury) against a number of key players in the Whitewater real estate case. Almost sure to appear before the grand jury: Gov. Jim Tucker of Arkansas and Web Hubbell, former partner in the Rose Law firm of which Hillary was a partner. **Russell comment:** Should be very interesting.

* *

One test of the new Republican led Congress is whether they will make Congress people more like the rest of us. The task will fall to Rep. Jim Nussle, and the first thing he did was he read the Constitution. Everything is up for grabs -- administrative and legislative offices, personnel, perks and privileges. He will look at everything including salaries and pensions. Examples: Defeated Rep. Rostenkowski will get a pension of $98,462. Defeated Rep. Brooks of Texas will receive $96,462. Sen. James Sasses, $53.289. Fact: only 59% of Americans receive any pension benefits and the average retired worker's Social Security benefit is $8,088. At present, Congress receives among other things taxpayer-subsidized health insurance, life insurance, pensions, gyms, barber shops and beauty shops. Says Pete Sepp, Spokesman for the National Taxpayers Union, "Taxpayers will think that many departing incumbents have won the lottery, a huge pension, the lion's share funded by taxpayers." **Russell question** -- How much longer do we have to put up with this? "Listen, I'm mad as hell, and don't want to take it anymore."

* *

Quote by Michael Tomasky from New York's very liberal *Village Voice:* "Does anyone seriously believe that, in the current climate, a Democratic Party that stands for single-payer health care, deeper military cuts, less welfare reform, and a corporate tax increase will be able to pull votes? If you do, I invite you to visit Earth sometime from whatever planet it is you've been sleeping on."

* *

Health: the verdict is finally in -- cholesterol-lowering drugs reduce deaths. They must work, I'm still around. I have congenitally high cholesterol (over 320), but I went on the experimental Mevacor program (Merck product) many years ago before the FDA approved the drug. No variety of diet could bring my cholesterol down. But Mevacor did. My cholesterol count is now around 200, sometimes down to 190. The recently concluded study out of 94 clinical centers in Denmark, Finland, Iceland, Norway and Sweden (conducted by Merck) showed that those treated with a statin drug showed a very significant 30% lower death rate. Catch -- the drugs are very expensive, you can easily spend $1,000 a year for Mevacor (Lovastatin), but what the heck, it's only your life . . . Another recent study shows that when you're over 70, it doesn't matter what your cholesterol count is. I'm not sure I believe that -- maybe it's saying that if you can make it to 70 or over, you're on your own, or it's just how good your genes are. On that count, I guess I'm OK, my mom died at 92, not of any disease, she just got tired of living.

* *

Are all dictators nutso, or is it total power that sends them to the funny farm (absolute power corrupts absolutely)? Now it turns out that China's Mao (who professed asceticism and publicly denounced sex) was a total pervert, a voracious sexual madman, who often slept with three, four or five young maidens at a time. And how about Saddam? It turns out that while most Iraqis are destitute, this madman has spent $1 billion on a series of palaces and presidential retreats around the country. This information will be used before the UN's Security Council as part of the argument to continue sanctions against Iraq.

* *

In a survey of European businessmen, half of those quizzed believe China and south-east Asia are likely to outstrip North America and Europe in economic power by early next century. The survey was carried out among 1,500 companies in Germany, France, the UK, Italy, Spain and Belgium. Europe's leading industrialists are confident about the short-term outlook, but about one-third say they will continue to cut back on their work force. 70 percent of the companies said that Europe is not investing enough in research while 56% said investment in training is inadequate. Russell comment: I believe that high taxes, over-consumption and inadequate savings are long-term negatives for both the US and Europe. Places like Hong Kong, with very low corporate taxes and now capital gains taxes and high savings have a huge long-term advantage over the Western capitalistic nations. China is watching the situation carefully. And with high savings, a great work ethic and a willingness to learn, they promise to be tremendous competition (already our trade deficit with China has reached a whopping $18 billion). China will be the next super-power, count on it.

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The nation's largest natural gas company, Enron Corp., is going to build the largest plant ever to produce power from sunlight. The plant will be built in southern Nevada and should be in operation in 1996. Enron says it will produce power from photo voltaic panels at a price of 5.5 cents a kilowatt hour, which would beat the price the government is paying (5.8 cents) for electricity. A partnership between Energy Conversion Devices of Troy, NY and Canon Electronic of Japan plans to open the world's largest thin-firm solar cell plant in Newport News, VA next year. **Russell comment:** The age of solar power is approaching, bet on it.

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Good and Bad: I went to the San Diego swap meet last Saturday, and I stopped to look at a pile of old *Life* magazines, circa 1950s. Do you know that *Life* in the '50s had a circulation then of over six million? Everybody and his brother used to read the weekly

Life. Today, the monthly *Life* is a pitiful, uninteresting, poorly printed little magazine. And it's a shame.

On the other hand, we have *American Heritage* (published by *Forbes*), a terrific magazine just chocked full of fascinating articles. The magazine is beautifully printed, and should be collected for its valuable historical pieces alone. The current issue includes an excellent interview with Walter Cronkite. On TV, Cronkite says, "I'm afraid that those who expected to be fully informed by TV expected what could not be, and the fact that TV was being accepted as the principal news source by a greater and greater percentage of our population was creating considerable difficulties for our democracy. An uninformed democracy is dangerous. Thomas Jefferson told us that the country that expects to be ignorant and free expects what never can, and never will be. We are perpetuating ignorance by making TV news so easily assimilated that people do not go to print any longer. This is dangerous."

Russell comment: I agree 100%. Newspaper circulation nationally is shrinking. And reading and writing skills are diminishing (try to find a college graduate who can write well). I read 12 newspapers a day in an effort to keep informed. I walk around our neighborhood early in the morning, and I'm surprised at how few homes get the morning newspaper. TV has indeed taken over, and TV news is almost always shallow (unless it's a murder story), and usually slanted towards the exciting or sensational, rather than the informative.

PRECIOUS METALS: Silver under five dollars, gold under 380, the action of the metals, as I see it, is deflationary. Of course, with interest rates rising, the penalty for holding the metals increases (I'm talking about the penalty in terms of lost interest income).

Ostensibly, the Fed has been fighting "tomorrow's inflation," although actually I believe the Fed has (by boosting rates) been trying to shore up a weak dollar. The public's been told over and over again that it's inflation that the Fed is fighting. Therefore, it's inflation that the public and most investors are preparing for.

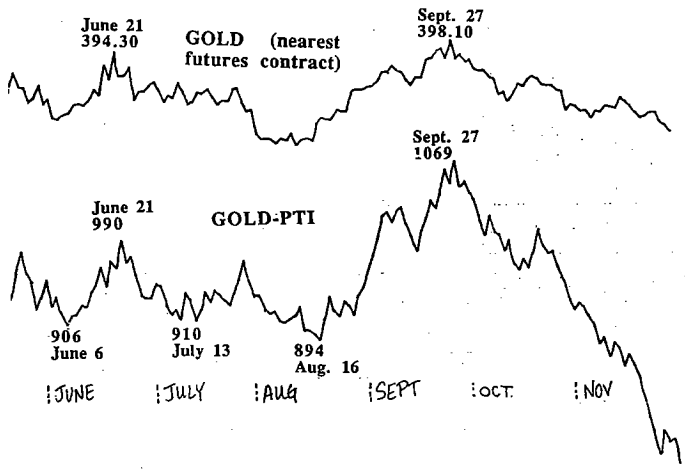
But what happens if the nemesis is deflation, not inflation? If deflation is the wave of the future, then all eyes will be fixed on that all-American monster, the **"debt bubble."** Why? Because debt becomes increasingly difficult to carry during a deflation. The US is now the world champion of debt. We're loaded with $15.9 trillion in debts of every conceivable variety -- government, corporate, and individual. Carrying that kind of debt during inflation is do-able. Carrying it during a deflation verges on the impossible.

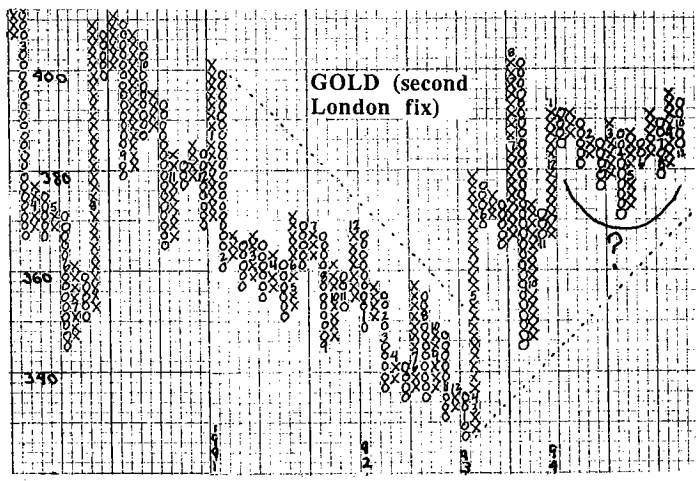
Since the dollar is basically a product of debt, the arrival of real deflation would be decidedly negative for the dollar. If deflation arrives, the US debt situation will become a total nightmare. Federal law states that the dollar is legal tender for all debts. That's the law. But aside from a government edict, there's only one positive holding up the dollar; it's called **confidence.** If confidence goes, the dollar goes, it's as simple as that.

In a deflation, I can see gold going down initially, as people sell gold in an effort to boost liquidity. But as deflation continues, I can envision a frantic rush back into gold, since gold is the only real money, money with no debt or liabilities against it.

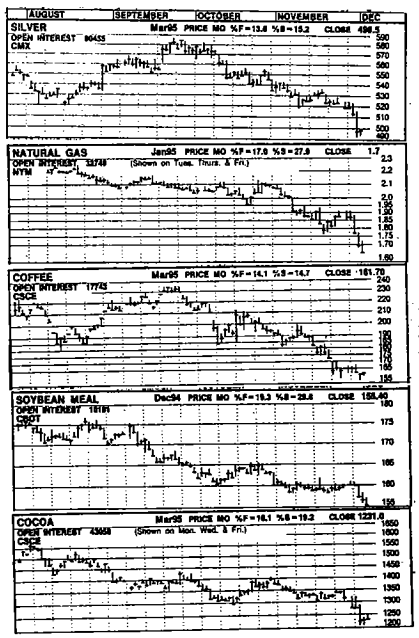
So much for theory; now let's get down to what's actually happening. There's only one word to describe my Gold-Primary Trend Index; the word is "ugly." But give the Gold-PTI credit, it did its work for us -- it foretold of the trouble in the precious metals that we now see. From its Sept. 27 peak of 1069, the G-PTI had dropped steadily -- to a new low below 750. (Hopefully, that huge drop has rendered the gold market "over-sold".)

But all is not lost. My point & figure chart shows that gold is still in a consolidation pattern. However, the first minor breakdown level would be 368 based on the second London gold fix. A much more serious breakdown would occur if gold hits a price of 368 or below. If 368 is struck, the next support would be the rising trendline at 360.





LATE NOTES: You say you haven't noticed any deflationary trends? Then check the items below.



Farm Prices At 6-Yr Low

Falling hog prices and a sharp drop for corn pushed the index of prices received by farmers for their goods to a six-year low in November, the Agriculture Department reported. Although cattle prices rose slightly, they still remained low, doing little to prevent the overall index from dropping 0.8% from October. Compared with November 1993, prices were 8.3% lower. The index is the lowest since April 1988.

LATE NOTES: Dec. 2, Friday crude oil down a whopping 83 cents -- to 16.99 a gallon, while gold and silver also slump (silver down a staggering 21 cents). On the same day the Dow surges over 44 points. Bonds and the dollar have (finally) carved out impressive bottoms and "should" now be ready to rally. And yes, the stock market also appears ready to advance -- maybe strongly -- and maybe into January -- **but with January could come trouble.** Jobless rate in Nov. fell to 5.6% (a four-year low) -- this suggests **another rate boost**, which should arrive within a few months. The bear is ready to back off a bit -- he's done enough damage for '94. Enjoy the respite.

NEXT MAILING: Dec. 21, 1994